

FITCH RATES HOWARD COUNTY, MD'S \$198.55MM GOS 'AAA'; OUTLOOK STABLE

Fitch Ratings-New York-24 April 2019: Fitch Ratings has assigned a 'AAA' rating to the following Howard County, Maryland bonds:

--\$131.8 million consolidated public improvement project and refunding bonds, 2019 series A;
--\$66.7 million metropolitan district project and refunding bonds, 2019 series B.

Bonds proceeds will be used to reimburse the county for the cost of public improvements and to repay all or a portion of the county's outstanding general obligation (GO) bond anticipation notes.

The bonds are scheduled to sell on a competitive basis May 15.

The Rating Outlook is Stable.

In addition, Fitch has affirmed the following ratings:

--Issuer Default Rating (IDR) at 'AAA';
--\$1.5 billion outstanding GO bonds at 'AAA'.

SECURITY

The GO bonds are payable from the county's full faith and credit pledge and its unlimited taxing power.

ANALYTICAL CONCLUSION

Fitch expects the Howard County to maintain a high level of financial flexibility throughout economic cycles, consistent with a long history of sound operating performance and healthy reserves, and a superior level of inherent budget flexibility. The county's strong financial profile reflects strong revenue growth prospects from a growing property tax base, manageable expenditure growth and a demonstrated ability to reduce expenditures during economic downturns. Fitch expects the county's long-term liability burden to remain low. Management practices are sound, including the maintenance of healthy reserves and use of reserves for capital and maintenance needs, which along with the county's high legal ability to raise revenues provides for future financial flexibility.

Economic Resource Base

Howard County is a wealthy Baltimore-Washington, D.C. suburban enclave with a diverse local economy. As of 2017, the county's population was 321,113 and has increased 12% since 2010.

KEY RATING DRIVERS

Revenue Framework: 'aaa'

Fitch expects the natural pace of general fund revenues to perform in line with GDP over the long term based on strong economic activity and continued investment in the county. The county has the independent legal ability to raise property tax revenues without limit, contributing a superior level of inherent budget flexibility.

Expenditure Framework: 'aa'

Fitch expects natural growth in spending to generally track revenue growth in the future. Education drives the county's spending needs and is somewhat inflexible in that any reduction in funding levels would require approval from the state. Nevertheless, the county's ability to make other spending cuts when needed is solid given its strong legal control over employee-related costs and staffing levels. Carrying costs related to debt, pensions and other post-employment benefits (OPEB) are moderate.

Long-Term Liability Burden: 'aaa'

The county's liability burden is largely debt driven and low relative to its expansive resource base. Projected debt needs are manageable despite expectations for continued growth in population and service demands.

Operating Performance: 'aaa'

Fitch expects the county to maintain a high level of fundamental financial flexibility throughout economic cycles based on its expenditure and revenue flexibility and expectation for compliance with a conservative fund balance policy. Financial operations are supported by solid economic and revenue prospects.

RATING SENSITIVITIES

MAINTENANCE OF STRONG FINANCIAL PROFILE: The rating assumes the county's continued strong financial flexibility, revenue growth prospects and budget controls.

CREDIT PROFILE

The county is among the wealthiest in the nation, featuring a highly educated workforce employed throughout a deep and diverse economy led by the federal government. Fort Meade, located in nearby Anne Arundel County (AA+/Stable), is a major driver of long-term regional growth and is one of Maryland's top employers. The fort, already a home base to all five military services and several federal agencies including the National Security Agency (NSA), has been named the headquarters for the U.S. cyber-security center. The county estimates that federal agencies located at Fort Meade employ approximately 12,000 to 15,000 county residents.

The education and healthcare sectors, led by John Hopkins University Applied Physics Laboratory, play a pivotal role in the economy and lend diversity to the notable concentration in government. Employment growth remains steady, as the county continues to generate and retain jobs through its economic development efforts. The unemployment rate remains well below the state and national averages.

The county continues to focus its economic development efforts in downtown Columbia. Tenable, Inc., a cybersecurity software company, is expanding its company headquarters and adding employees. Intralytix, a biotech research and development company that manufactures bacteriophage-based products, is relocating its headquarters and operations to Columbia and bringing 45 new jobs and \$100 million in capital investment. Occupancy is expected in January 2020.

Revenue Framework

Property taxes are the largest revenue source for the county at 51% of fiscal 2018 general fund revenues followed by income taxes at 42%. Assessed values (AV), which lag the actual housing market due to the statutory rolling three-year reassessment cycle in Maryland, have increased consecutively over the past six years at growth rates mostly in line with GDP. AV is projected to increase to \$54.9 billion in 2020, which is a 3% increase over 2019.

According to audited fiscal 2018 results income tax revenues increased 7% for the year, marking the seventh consecutive year of gains. The fiscal 2018 jump was fueled by increased capital gains, compared to flat performance the year prior. The county is projecting a 2%-3% increase in income tax revenue in fiscal 2019.

The county's natural pace of general fund revenue growth has trended in line with inflation when revenues are adjusted for tax policy changes over the past decade. However, given ongoing economic development as well as positive housing and employment trends, revenue growth prospects are strong.

The county is not subject to any limitation on its property tax rate or levy and has not increased the property tax rate in nearly two decades. The income tax rate was increased in 2004 to the maximum rate of 3.2%.

Expenditure Framework

The county's largest expenditure category is education at roughly 59% of fiscal 2018 general fund expenditures, followed by public safety at 12%.

Based on the county's history of structural budgetary balance and no immediate significant spending pressures, Fitch expects spending growth to remain in line with revenues.

According to the state's maintenance of effort (MOE) mandate, education spending cannot decline year-over-year without state approval. Approximately 50% of the county's workforce is unionized with one-or two-year contracts. Strikes are not permitted. Arbitration may be legislatively authorized by the county council and results are binding on the county executive.

Carrying costs associated with debt service, actuarially determined pension payments (including the normal cost for teachers' pensions) and OPEB actual contributions totaled about 15% of fiscal 2018 governmental spending; debt service accounted for about 8%. Given the county's plan to increase its contribution to OPEB, carrying costs should increase but flexibility of main expenditures is expected to remain solid.

Long-Term Liability Burden

Overall net debt plus the county's unfunded pension liability approximates a low 7% of personal income, excluding self-supporting metropolitan district utility debt. Debt ratios increase slightly to nearly 8% including metropolitan district debt, which is paid from special assessments and charges levied against all property in the district for utility purposes. While operating revenues (water and wastewater) historically have been sufficient to cover metropolitan district operating expenses and debt service, during fiscal 2017 and 2018 the district utilized enterprise fund balance to fund operations -- including the payment of debt service. The general fund does not provide support to utility operations, and the metropolitan district maintains good legal rate-setting flexibility and liquidity. Utility rates are subject to county council adoption and have not been increased since 2014 (there is a plan to increase rates in fiscal 2020). currently no plan to increase rates). As of fiscal year-end 2018, current cash on hand in the metropolitan district fund exceeded \$41 million or more than 160 days of operations.

The county is currently under contract with a private consortium (Edgemoor-Star America Judicial Partners) for the construction of a new circuit courthouse via a Public Private Partnership (P3) Agreement. The cost of the project is approximately \$167 million. The county plans to issue approximately \$75 million of general obligation bonds in 2021. The county will make ongoing annual availability payments for the 30-year term of the project agreement. The availability payment will include a \$6.6 million capital charge component and \$3.3 million facility management charge. The project company will use the availability payment to cover loan repayments/debt service on the outstanding debt associated with the PPP. When incorporating this

debt, the county's long-term liability ratio increases to 8% of personal income, when adding the metro district the ratio would increase to about 9%.

The county will repay approximately 61% of outstanding principal within 10 years following this issuance, leaving adequate capacity to fund future borrowing needs. The county's fiscal 2020-2024 capital plan totals over \$1.8 billion, excluding water/sewer projects. While the plan includes approximately \$1 billion of bond proceeds, the county expects actual future borrowing to approximate \$100 million annually, allowing the county to maintain debt service costs at 10% of revenue or less. Although the amount of total debt outstanding is expected to increase, increasing personal income should keep the long-term liability ratio comfortably within the 0%-10% range for a 'aaa' assessment.

The county provides pension benefits to its employees through two single-employer defined benefit plans, a general employee plan and a fire and police plan, and annually makes the actuarially determined contribution (ADC) to each. As of July 1, 2018, the plans had an aggregate net pension liability (NPL) of close to \$412 million or only about 2% of personal income, adjusted to reflect Fitch's standard 6% investment rate of return; the Fitch-adjusted ratio of combined assets to liabilities was 67%. The county also provides a length of service plan for volunteer public safety employees, which has a minimal net pension liability (\$22.6 million).

The county administers an OPEB trust fund that provides benefits for its retirees, which has a balance of about \$104 million as of fiscal 2018 year-end. As of June 30, 2017, the unfunded liability is \$1.1 billion or a moderately high 5% of personal income.

Operating Performance

The county's 'aaa' operating performance assessment is based on Fitch's view of the county's superior inherent budget flexibility in conjunction with its stable and high reserves and expected low revenue volatility through economic cycles. Fitch expects the county would maintain reserves in compliance with its fund balance policy of 7% of general fund spending, which Fitch considers a high reserve cushion considering the modest revenue decline depicted by the Fitch Analytical Sensitivity Tool in year one of an economic downturn.

In response to a weak revenue growth environment during the last recession, the county used reserves to balance operations. During the subsequent recovery the county rebuilt reserves to currently healthy levels. The unrestricted general fund balance of \$128 million at fiscal year-end 2018 was equal to 11.9% of spending. The unrestricted fund balance includes the county's budget stabilization reserve, which is held within the committed fund balance and according to county charter is to be maintained at 7% of spending. During fiscal 2017 the county established an additional reserve of \$5 million in the assigned portion of the fund balance. The county plans to increase this reserve to 3% of general fund spending over the next 10 years. The county funds fire & rescue services mostly with property taxes outside of the general fund. When Fitch combines these funds the available fund balance increases reserves to \$144.2 million or about 13% of combined spending.

The adopted fiscal 2019 general fund budget kept the tax rate stable but included a \$23.2 million fund balance appropriation. The majority of the appropriation was a one-time \$11 million payment to address a deficit in the school board's health and dental fund. The budget also funded \$7 million in road resurfacing. Year-to-date operating results suggest a smaller use of fund balance (2% of spending).

The proposed 2020 general fund budget of \$1.2 billion is a 1.8% increase over fiscal 2019. The proposed budget keeps the real property tax rate stable but includes a six cent increase to the fire and rescue tax rate. The fund balance appropriation is reduced to \$9.3 million. The budget increase funds a new class of fire and emergency services workers, and more than a \$16 million increase to

the school system. The budget also includes \$15 million for flood mitigation to address flooding in Ellicott City following two major incidences in 2016 and 2018. The state in conjunction with the Maryland Department of Housing and Community Development will be granting over \$11 million in funding to support the county's flood mitigation efforts. Based on the county's multi-year financial forecast, Fitch expects operations to remain generally balanced and reserve levels to remain above the county's 7% policy minimum.

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Additional information is available on www.fitchratings.com

Applicable Criteria

U.S. Public Finance Tax-Supported Rating Criteria (pub. 03 Apr 2018)

<https://www.fitchratings.com/site/re/10024656>

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